

Press Release

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Diesel emissions debate accelerates strategy change

- **Commerzbank publishes new sector report: Automotive Suppliers 2017**
- **Record 2017 revenues of €78.9 billion forecast for the sector in Germany**
- **Electromobility as a blessing and a curse – connected and autonomous driving push up investments – innovative power becoming vital**

Diesel emissions debate accelerates strategy change

The number of people interested in buying a diesel car keeps falling: in June of this year, only just under 40 per cent of newly-registered vehicles were fitted with a diesel engine – down almost 20 per cent year-on-year. This slump might well reflect consumer uncertainty, caused by the 'Dieselgate' affair as well as by fears of diesel cars being banned from inner cities. "Consumers' new 'diesel angst' has far-reaching consequences for the automotive industry: the key fleet business is facing upheaval", explains Cedric Perlewitz, Sector Head Automotive, at Commerzbank in Frankfurt. "This calls upon manufacturers to significantly accelerate their strategic change, focusing on electromobility", Perlewitz adds. Falling demand for diesel-fuelled vehicles puts pressure on resale values, thus driving up the cost of leasing diesel cars.

Automotive groups are facing tightened legal requirements for carbon dioxide emissions, together with new thresholds for particulates and nitrogen oxides – driving up research and development costs for manufacturers, whilst sales of diesel vehicles are declining. Yet the future of diesel engines is only one of many issues manufacturers and suppliers currently have to deal with. "The automobile industry is undergoing the most fundamental change it has seen for decades. On top of diesel engines, manufacturers need to contend with four key mega trends: electromobility, connected and autonomous driving, as well as mobility services", Perlewitz maps out the survey results of Commerzbank's current sector report on automotive suppliers. "At the same time, the current debate holds a great opportunity for the automotive industry: to accelerate the impending transformation process and strategic change. Thanks to their leading market position and strong balance sheets, German manufacturers and suppliers can actively contribute to shaping the industry's change", Perlewitz says.

Electromobility: blessing and curse

An ever-growing number of Germans can see themselves choosing an electric vehicle next time they are looking to buy a passenger car. However, this still requires marked improvements in terms of prices, charging times, and range. Perlewitz explains: "Customers' expectations regarding the infrastructure are considerable – but political pressure on manufacturers is greater still. Hence, whilst the prospects for a growing market are a blessing for electric vehicles, the curse for the industry lies in the costs incurred for research and development, and in the time pressure." Whilst German car manufacturers had originally devised their strategies for a mass market in electric vehicles to occur towards the end of the next decade, a growing number of experts now envisage this at a much earlier stage. This is why the industry is now looking somewhat wistfully towards Asia, where most of the manufacturing expertise for car battery cells is concentrated. Nevertheless, joint efforts by automotive groups and politicians in order to establish battery-powered vehicles on the mass market are gaining speed. For these efforts to succeed, marked improvements in the price/performance ratio will be necessary. Hybrid passenger cars will provide an interim solution over the medium term. To comply with even tighter carbon dioxide emissions limits, suppliers and manufacturers will need to further optimise combustion engines, gearboxes, tyres, and aerodynamics.

Connected and autonomous driving push up investments

Both connected and autonomous driving are key items for research and technological innovation. At 58 per cent, German suppliers and manufacturers hold the highest share in patents for autonomous driving worldwide; they already operate self-driving test vehicles. Before these come to the market, however, significant legal hurdles will need to be overcome. "I only expect fully autonomous driving post-2025", Perlewitz states. Even though established automotive suppliers have built a strong market position in driver assistance systems, leveraging many years of experience in this field, technology developments are now occurring very rapidly indeed. "Especially in 'car-to-X' communications – the electronic data interchange between the vehicle and the infrastructure – competitors from outside the industry represent a serious threat, which might leave established automotive suppliers behind", sector head Perlewitz underlines. 80 per cent of new cars registered in Germany are already connected. Security and driver assistance, as well as information and communications systems are increasingly being used, including in the compact cars segment. Commerzbank expert Perlewitz outlines the situation: "Digitalisation and networking trigger fundamental change in the automotive sector. Car manufacturers and suppliers must evolve from traditional production towards the provision of mobility services." This requires significant investment into their own software expertise and/or new digital business lines, both organically and through acquisitions. "The need for digitalisation will trigger more company takeovers – both within the automotive sector and across other sectors", Perlewitz adds.

At the same time, interesting start-ups are drawing attention. At this year's edition of Commerzbank's Automotive Colloquium, three start-up businesses presented their solutions to the future issues of electromobility, networked driving, and mobility services. Specifically, Ubitricity has developed a solution to convert simple street lights into charging points: using 'intelligent' charging cables, this can allow electric vehicles to be charged everywhere, at low cost. Start-up German Autolabs will shortly launch its first 'digital passenger', which will leverage artificial intelligence in order to control driver communications depending on the situation at hand. Conversely, door2door – yet another start-up – is pushing the concept of shared

mobility, linking users' smartphones with a fleet of minibuses serving as on-demand shuttles, with ride requests pooled intelligently.

Innovative power becomes vital

"Automotive manufacturers and suppliers have increasingly evolved into digital technology groups. The future will see wholly new business models, which we are only scarcely aware of right now", Perlewitz believes. Current challenges will accelerate the pace of change in the automotive industry even further. In this context, the automobile universe is increasingly being penetrated by Big Data players as well as numerous start-ups. For the first time in the industry's 130+-year history, vehicle manufacturers and their suppliers are no longer a closed society. This means that innovative strength has turned into one of the most important competitive factors.

"With 2017 revenues of €78.9 billion, we forecast automotive suppliers in Germany to post yet another record year", Perlewitz states, adding: "Given high investment costs and increased competition, we anticipate subdued profits from 2018 onwards."

The report is based on analyses and assessments of the sector, provided by the following Commerzbank AG units:

Segment: Corporate Clients
Division: Research
Department: Economic Research

Segment: Corporate Clients
Division: Advisory & Primary Markets
Department: Sector Team Automotive & Transportation

Segment: Group Risk Management
Division: Credit Risk Corporates
Department: Sector Team Automotive

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